SUMMARY of COOPERATIVE CASES

FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D. C.

LEGAL SERIES NO. 1

APRIL 1957

UNITED STATES DEPARTMENT OF AGRICULTURE
FARMER COOPERATIVE SERVICE
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The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

SPECIAL NOTICE

All the cases of lasting interest which have been reported in Summaries Nos. 1 - 69, inc., (March 1939 - November 1956) have been included in Farmer Cooperative Service Bulletin on "Legal Phases of Farmer Cooperatives," which is now undergoing revision and reprinting. Accordingly, it seems desirable to start a new series of the Summaries with this issue. In the New Series, paging will run consecutively through a calendar year and in the last issue of each year an index will be included. This index will be issued on a cumulative basis in subsequent years. It is hoped that this will make the Summaries more useful to their users.

PATRONAGE REFUND CREDIT CURRENTLY TAXABLE
TO AN ACCRUAL BASIS PATRON

(Long Poultry Farms, Inc., 27 T.C. No. 120)

In the first accrual basis taxpayer case to reach the Tax Court for several years, the Tax Court has refused to follow its recent rulings in the cash basis taxpayer cases. In the instant case, the Court held that a patronage refund credit allocated to the account of a member who kept his books and reported his income on an accrual basis was a properly accruable item of income at its face amount and during the year in which the allocation was made.

Excerpts from the opinion follow:

> "The only issue is whether petitioner received taxable income by virtue of a so-called patronage dividend which was credited to its account during its fiscal year ended June 30, 1953, by a poultry marketing cooperative of which it was a member and patron.
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> * * * * * *
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> "Petitioner was incorporated in 1946 as a Virginia corporation with its principal place of business in New Market, Virginia. It was the successor of Long Produce Company, a partnership. * * * Petitioner kept its books and records and reported its income on an accrual basis.
>
> "Petitioner was a poultry raiser, and during the years in issue was a member of the Rockingham Poultry Marketing Cooperative, Inc., of Broadway, Virginia (hereinafter referred to as Rockingham). The general plan under which Rockingham operated was to provide centralized marketing facilities for its members and patrons, and at the end of each year to allocate to the members and patrons their proportionate share of the Cooperative's earnings. In order for it to maintain a revolving capital fund for its operation, the bylaws of the Cooperative provided that its members and patrons would currently furnish money for its capital through their patronage. The Cooperative, at the discretion of its directors, might retain all patronage refund credits, allocated to its members, for its use for so long as it wished. If the Cooperative sustained a loss in any year, the directors were authorized to reduce capital contributions or previous patronage refund credits on a proportionate basis. All debts of the Cooperative, both secured and unsecured, had priority over patronage refund credits. Such credits were not transferable.

"Rockingham was an organization exempt from taxation under the provisions of section 101 (12) of the 1939 Code.

"On April 1, 1953, Rockingham wrote petitioner a letter reading, in part, as follows:

> "'Based on the tonnage which you delivered as an individual grower to the plant during the year, you are entitled to a patronage refund credit of $6,781.94, which has been entered to the credit of your account as of this date. Please keep this letter for your own personal record, together with previous information sent to you, in order that your records will be complete.
>
> "'This credit will be redeemed in cash at a later date and you will be notified when it is payable. Do not present it for payment until you are notified.'

* * * * * *

"Rockingham was in sound financial condition at the end of 1952.
* * *

* * * * * *

"After receiving the notice of the credit to its account from Rockingham, petitioner's president attempted to borrow money at a Charlottesville, Virginia, bank on the letter, but was unable to do so. Petitioner's president likewise attempted to obtain some cash from Rockingham itself, on the letter, but was unable to do so.

"On its income tax return for its fiscal year ended June 30, 1952, petitioner did not accrue and report a patronage credit from Rockingham in the amount of $20.98, nor a similar credit received from another cooperative in the amount of $10.00. Respondent determined that such credits should have been accrued and reported, and petitioner did not contest that determination.

"On its income tax return for its fiscal year ended June 30, 1953, petitioner reported the amount of the patronage refund credit received from Rockingham in that year in the amount of $6,781.94 as taxable income. It now claims that such amount should not have been included in income, and claims a refund for taxes paid for that fiscal year and the preceding one, by virtue of a loss carryback.

"OPINION.

"RICE, Judge: The petitioner argues that the patronage refund credit allocated to its account on Rockingham's books had no fair market value when received, and that because of that fact such credit was not properly includible in its income during the fiscal year here in issue, citing B. A. Carpenter, 20 T.C. 603 (1953), affd. 219 F. 2d 635 (C. A. 5, 1955), William A. Joplin, Jr., 17 T. C. 1526 (1952); and San Francisco Stevedoring Co., 8 T. C. 222 (1947). The respondent, on the other hand, argues that the patronage refund credit was properly accruable and taxable to petitioner during such year on the authority of Harbor Plywood Corporation, 14 T. C. 158 (1950), affd. 187 F. 2d 734 (C. A. 9, 1951); and George Bradshaw, 14 T. C. 162 (1950).

"Petitioner's reliance on B. A. Carpenter and William A. Joplin, Jr., supra, is misplaced because in both of those cases the taxpayers kept their books and reported their income on the cash basis.

"Petitioner here was an accrual basis taxpayer. It has long been recognized that a taxpayer using such a system of accounting must accrue as income any unconditional right to receive an amount of money in the year in which he acquires the right, even though actual payment of the sum is deferred until some later date. Spring City Co. v. Commissioner, 292 U.S. 182 (1934).

"The exception to that rule is where there is a real uncertainty as to whether the taxpayer will ever receive the amount in question. The petitioner attempts to show that such was the case here, relying on San Francisco Stevedoring Co., supra. In that case we found that there was an uncertainty qualifying the payment which the taxpayer there was entitled to receive. We said that it was not only uncertain in the year in which the taxpayer received the right to the payment that it would actually receive the payment itself, but that it was uncertain as to whether the payment would ever be made. That was not true of the credit allocation which the petitioner received here. It had an unequivocal right to receive the sum of $6,781.94, and while there were some remote contingencies that the amount might possibly be reduced, the only real uncertainty was the time of payment. Rockingham was in sound financial condition at the end of 1952; and, from the time when petitioner first became a member in 1946, it had realized substantial net savings during all of the ensuing years here material. In the face of those facts we are unable to distinguish this case from Harbor Plywood Corporation and George Bradshaw, supra. In both of those cases, the taxpayers' right to receive the sum was unconditional and only the time when they could expect payment was uncertain.

"We therefore conclude that the credit allocation in the amount of $6,781.94 which petitioner received from Rockingham was a properly accruable item of income in its fiscal year ended June 30, 1953."

UNIONS VERSUS COOPERATIVES AS BARGAINING AGENTS FOR FARMERS

(In the Matter of Puget Sound Salmon Canners, Inc., et al., F.T.C. Docket No. 6376)

(In the Matter of United Fishermen of Alaska, et al., F.T.C. Docket No. 6368)

Recently there has been activity in several parts of the country to organize unions of farmers to replace cooperatives as bargaining agents, particularly in the dairy field. Two cases decided in 1956 by the Federal Trade Commission suggest, by analogy, that such efforts may run counter to antitrust and fair trade laws. The basic reason is that farmers are considered as independent entrepreneurs, not persons who work for wages.

In the first case cited above (In the Matter of Puget Sound Salmon Canners, Inc., et al.) the respondents were charged, among other things, with entering into a combination to fix prices in violation of the Federal Trade Commission Act. The Commission finally sustained a decision directed against three of the respondents, an association of canners, a vessel owners association, and a Union directing that they discontinue their contracts with respect to the price of salmon.

One of the principal defenses of the Union was that the crew members were in fact employees of the canners, and that the agreements constituted nothing more than agreements between employer and employees as to wages. The initial decision held against the Union on this point. The Union appealed, relying in part on the examiner's refusal to issue a subpoena duces tecum requested.

In holding that the examiner did not err in refusing the request, the Commission said, in part:

"The record clearly shows that the skippers of Purse Seine Vessels are independent businessmen. They own their own gear and sometimes their own vessels. They employ their own crews and assume the responsibility for withholding any income tax or social security payments of the crews. They also arrange and pay for any liability insurance. Insofar as the actual fishing operations are concerned, the skippers fish when and where they want to without reference to any Canner to which

they sell fish. Moreover, whether or not a Canner owns or holds a mortgage on a vessel has no bearing on the skippers' control of the fishing operations. Neither the skippers nor their crews are shown to be employees of individual Canners. The relationship involved is that of sellers and buyers of fish. Columbia River Packers Association, Inc. v. Hinton, et al., 315 U.S. 143 (1942); Hawaiian Tuna Packers, Limited v. International Longshoremen's and Warehousemen's Union (C.I.O), et al., 72 F. Supp. 562 (D.C. Hawaii, 1947); Local 36 of International Fishermen & Allied Workers of America, et al. v. United States, 177 F. 2d 320 (C.A. 9, 1949), cert. denied 339 U.S. 947."

In the second case cited above (In the Matter of United Fishermen of Alaska, et al.), a fishermen's Union, a fishermen's cooperative, and three canners of King crabmeat, were charged with a combination and conspiracy to fix prices and restrain commerce and competition in King crabs and crabmeat. The fishermen's cooperative was organized in compliance with the Fishermen's Cooperative Act (15 U.S.C.A. 521, 522), which is similar to the Capper-Volstead Act.

Pertinent parts of the summation in the Initial Decision, which was sustained by the Commission, are as follows:

"23. It is apparent from these incidents that the difficulty between the Wakefield company and respondents was in no sense a 'labor dispute', involving wages, hours, working conditions, etc. Rather, the entire controversy revolved around the matter of crab prices. Unquestionably it was solely because of Wakefield's refusal to pay the fixed price of 9-1/2 cents that the Union was seeking to handicap the company by depriving it of workers.

"24. From a practical viewpoint, it is difficult to distinguish between the Union and the Association, to determine just where one ends and the other begins. As has been seen, practically all of the members of the Association were, until 1954, members of the Union, and many of them still are members of the Union for limited purposes. Moreover, there is constant shifting of members back and forth between the two organizations as the status of the various members changes from that of fisherman (crew member) to that of boat owner or captain, and vice versa. The principal officers of the Association were formerly the principal officers of the Union. Insofar as crab prices are concerned, the Association appears to operate exactly as the Union did before it; that is, it agrees with canners on a uniform price and each member of the Association then proceeds to sell his own crab to whichever canner he prefers, provided the uniform price is maintained. The price negotiations for

> the Association have for the most part been carried on by the same individuals who formerly negotiated for the Union. And the secretary-treasurer of the Union, who participated in the price negotiations by the Union, has been present during negotiations by the Association and to some extent at least has joined in the discussions. Also of significance is the fact that on both of the occasions on which officials of the Association went to the Port Wakefield plant of Wakefield Fisheries they were accompanied by officials of the Union. It is difficult to escape the impression that the purported separation of boat owners and crew members was more technical than real; that actually the Union is continuing to fix prices, using the Association as a means to that end.
>
> "25. In any event, it is apparent that the Union and the Association have entered into and maintained agreements and understandings between themselves and with others to fix the prices of King crab, and that they have sought to coerce a third party into paying such prices. The right of the Union and the Association freely to pursue their proper functions is in no way involved. What is involved is a price fixing combination and attempts to maintain and enforce such combination through coercion."

It is obvious from the foregoing analysis of the facts involved in this case, that the cooperative was not acting independently as a bargaining group.

It will be remembered that in July 1953, an indictment was returned against the Louisiana Fruit and Vegetable Producers Union, Local 312, and certain of its officers, in the United States District Court for the Eastern District of Louisiana. The indictment charged violation of Section 1 of the Sherman Act by the Union and its members and alleged that the Union members were independent entrepreneurs, not employees. It further alleged that defendants engaged in a conspiracy to fix prices of strawberries and other perishable produce, to boycott processors who purchased from nonmembers of the Union, to picket processors who refused to agree to purchase strawberries on the Union's terms, and to refrain from harvesting berries when deemed necessary to compel the processors to observe the Union's terms. The defendants pleaded quilty to the charges, and fines and suspended prison sentences were imposed by the court.

DENVER STOCKYARDS CASE RULING REVERSED BY CIRCUIT COURT

(Producers Livestock Marketing Association v. United States _____F. 2d _____)

The Tenth Circuit Court of Appeals reversed the decision of the Judicial Officer of the Department of Agriculture (see Summary No. 69, p. 6) and held that a regulation of the stockyard company was invalid on its face. The regulation in question had the effect of precluding the plaintiff, a cooperative, from engaging in buying and selling at country points for growers except for movement to the Denver yards and from giving marketing advice or service to growers except to ship to the Denver yards.

The court said in part:

> "At the hearing set before the judicial officer of the Department of Agriculture petitioner elected to rest without offering evidence, choosing to submit its case upon the sole ground that the regulation was invalid as a matter of law, illegal upon its face. The judicial officer, acting for the Secretary of Agriculture, ruled that the regulation was not invalid upon its face; that absent factual support relative to the potential or actual effect of the provisions of the regulation upon petitioner and the stockyard company he could not adjudicate whether the regulation would have a valid or invalid application; and dismissed petitioner's complaint. Aggrieved by the result and facing expulsion from the Denver yard upon violation of the regulation, petitioner seeks this review.
>
> "Being a public utility the stockyard company has the inherent right to adopt regulations in regard to those phases of its business which are secondary to its major functions. * * * Such right is not necessarily dependent upon statutory authority. But a regulation the effect of which is to govern not only the services rendered by the stockyard company but also services provided by a marketing agency and which, if disobeyed, will divorce the two, can be lawful only if issued in furtherance of the basic duty established by sec. 304 of the Act which provides:
>
> > "'It shall be the duty of every stockyard owner and market agency to furnish upon reasonable request, without discrimination, reasonable stockyard services at such stockyard...'
>
> "Our inquiry is thus limited to a determination of whether or not the proposed regulation has any possible lawful application to the

statutory duties imposed upon the stockyard company and the marketing agency 'to furnish reasonable stockyard services.' Stated more specifically: Does a stockyard company, in order to furnish reasonable stockyard services, have a right to restrict, by regulation, the diversion of the normal flow of livestock to its yard occasioned by any act of a marketing agency done within the normal marketing area of the yard?

* * * * * *

"The most casual study of Regulation 10(c) shows the intent and effect of the rule to be an attempt to safeguard what the stockyard considers its normal market. Marketing agencies are not prohibited from dealing elsewhere entirely but are denied the services of the Denver yard if they even 'endeavor to secure customers (within the prohibited geographic area) to sell or purchase elsewhere' than the Denver yards. The compulsion of the regulation is in immediate conflict with the requirement of Sec. 304 which contemplates and imposes the duty upon marketing agencies to render reasonable services to its customers at <u>every</u> stockyard where they do business. If by rendering reasonable service for a Colorado customer at one stockyard a marketing agency is prohibited from rendering reasonable service for the same or a different Colorado customer at another stockyard it is apparent that the agency cannot perform its statutory duty in one regard or another.

"Although it may be argued that attempts, successful or otherwise, by a marketing agency to divert business from a stockyard may result in disharmony between the parties and thereby lower the ability of both to render efficient service, still such argument, even if proved to be soundly based in fact, has no legal significance. The test of the validity of the regulation is not so dependent. Nor does the stockyard have the right to exclude from its yards those persons who lawfully trod upon its economic toes. The operation of a stockyard is affected with a public interest and devoted to a public use. Any properly exclusionary regulation must be based upon more than economic or personal desirability or its lack, for the duty to furnish services under the Act cannot be abrogated by considerations of the parties which might form a valid basis of private contract. Carnes v. St. Paul Union Stockyards Co., 164 Minn. 457, 205 N.W. 630; Nashville Union Stockyards v. Grissim, 153 Tenn. 225, 280 S.W. 1015; Farmers' Livestock Commission Co. v. U.S. (D.C.E.D. Ill.) 54 F. 2d 375.

"Stockyard companies are not monopolies and are in fact in active competition one with the other. The rights and duties thus occasioned must be correlated with the rights and duties of other entities recognized under the Act and, both, finally, with the paramount public

interest. An exclusionary regulation based upon diversion of business, such as we here consider, unlawfully restricts petitioner as a marketing agency and wounds the public interest. The persuasive words of the Supreme Court of Tennessee, passing upon the legality of a comparable situation, are in accord.

> "'Furthermore, we fail to find anything in the Packers and Stockyards Act that requires defendant or his employer to transact all of their business of receiving, buying and selling livestock on complainant's premises or from buying livestock and causing the same to be shipped to others than complainant. In other words, there is nothing in the act which requires . . . the defendants to do all their business with complainant . . . Nashville Union Stockyards v. Grissim, supra.'
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> * * * * * *
>
> "We conclude that Regulation 10(c) is an unlawful restriction upon the statutory rights and duties of petitioners and all market agencies and bears no reasonable relationship to the duties required of the stockyard company under the provision of the Packers and Stockyards Act. The regulation is invalid upon its face * * *"

SUPREME COURT DECISION IN FROZEN FRUITS AND FROZEN VEGETABLE CASE

(Home Transfer and Storage Co. v. Interstate Commerce Commission
325 U.S. 884, 77 S. Ct. 129, 1 L. Ed. 2d 82)

The Supreme Court of the United States has affirmed the judgment of the statutory three-judge Court for the Western District of Washington (141 F. Supp. 599; see Summary No. 68, p. 1) in the case cited above, holding in effect that frozen fruits and frozen vegetables are "agricultural commodities," and not "manufactured products" under Section 203 (b) (6) of the I.C.C. Act, Part II.

This decision by the Supreme Court would appear to settle the matter that under existing law motor trucks transporting frozen fruits and frozen vegetables in interstate commerce are not subject to economic regulation by the Federal government. This is an important decision for many cooperatives, particularly frozen fruit and vegetable processors. The net effect will be an increase in the number of motor carriers available to haul these commodities with increased competition for the business no doubt reflected in lower hauling charges.

RECENT INTERNAL REVENUE SERVICE RULINGS OF INTEREST TO COOPERATIVES

1. Patronage Refunds - When Excludable (Rev. Rul. 57-59; I.R.B. 57-7, p.7)

> Patronage dividend distributions, made by a nonexempt farmers' cooperative to its members who owned the crop at the time delivered to the cooperative, are excludable from the gross income of the cooperative if made in accordance with a pre-existing agreement. Similarly, if a nonexempt cooperative sells part of its products to members and the remainder to nonmembers but pays such dividends to members only, such dividends, to the extent attributable to sales to members, are excludable from the gross income of the cooperative, but any such dividends distributed to members, attributable to sales made to nonmembers, are taxable to the cooperative and to its members.

Advice has been requested as to the treatment, for Federal income tax purposes, of patronage dividend distributions in cash, merchandise, or document form, by a farmers' nonexempt cooperative marketing crops and selling supplies, where the members did not produce the crops but owned them at the time they were delivered to the cooperative and the cooperative distributes patronage dividends attributable to sales to members as well as nonmembers.

Patronage dividends distributed by a farmers' nonexempt cooperative on account of crops purchased from its members are excludable from its gross income to the extent they are distributed, on a true patronage basis in accordance with a pre-existing agreement, to members who owned the crops when they were acquired by the cooperative, even though such members did not produce the crops.

Similarly, if a nonexempt cooperative sells part of its products to members and the remainder to nonmembers, but pays patronage dividends to its member-patrons only, such dividends are excludable from the gross income of the cooperative to the extent they are attributable to sales to members and are allocated on a true patronage basis in accordance with a pre-existing agreement, even though member-patrons may purchase such products for resale to others.

However, profits distributed to members, which are derived from sales by the cooperative to nonmembers, are taxable to the cooperative and to the members. See I.T. 3208, C.B. 1938-2, 127; I.T. 1499, C.B. 1-2, 189 (1922), which hold, in part, that any profits made on business with nonmembers of a cooperative association which may be distributed to members in the guise of rebates are taxable to the association and the members; and S.M. 2595, C.B. III-2, 238 (1924),

which holds, in part, that profits made by a farmers', fruit growers' or like association, upon sale to nonmembers, constitute taxable income, irrespective of the fact that such profits were returned to members by reduction of cost or otherwise.

If patronage dividends which meet the foregoing requirements are not paid in cash or merchandise, but each distributee-patron is notified of the amount allocated to him pursuant to a pre-existing obligation, the principles stated in Revenue Ruling 54-10, C.B. 1954-1, 24, with respect to amounts that may be excluded by an exempt cooperative and the tax treatment thereof as to its patrons, are also applicable to a nonexempt cooperative and its patrons. Compare Colony Farms Cooperative Dairy, Inc. v. Commissioner, 17 T.C. 688, acquiescence, C.B. 1952-1, 1, and Southwest Hardware Co. v. Commissioner, 24 T.C. No. 12, acquiescence, C.B. 1955-2, 9.

Accordingly, patronage dividend distributions, made by a nonexempt farmers' cooperative to its members who owned the crop at the time delivered to the cooperative, are excludable from the gross income of the cooperative if made in accordance with a pre-existing agreement. Similarly, if a nonexempt cooperative sells part of its products to members and the remainder to nonmembers, but pays such dividends to members only, such dividends, to the extent attributable to sales to members, are excludable from the gross income of the cooperative, but any such dividends distributed to members, attributable to sales made to nonmembers, are taxable to the cooperative and to its members.

2. IRS to Conduct Study on Useful Life Expectancy of Depreciable Property (I.R.B. 57-10, p. 26)

The Internal Revenue Service has announced, in the March 11, 1957, Internal Revenue Bulletin, that it plans to undertake a study of the schedules of the useful lives of depreciable property contained in the 1942 edition of Bulletin "F." This study will include types of property not previously included as well as those presently listed.

An advisory group consisting of a representative from the Internal Revenue Service and two consultants from private industry have been appointed to work on the study. Additional representatives from the Treasury Department and the Internal Revenue Service will be appointed at an early date.

It is contemplated that the results of the study will be helpful in determining useful lives of property and equipment for income tax purposes. Accordingly, the Internal Revenue Service requests that interested taxpayers and representatives of industries and trade associations submit suggestions as to the types of depreciable

property to be included. Interested parties are also requested to submit in writing their experiences regarding normal useful lives, including, where practicable, applicable average useful lives of composite and group accounts. Operating conditions, technological improvements, and economic changes will be considered important factors in determining normal useful life expectancies.

Suggestions and related data should be submitted in duplicate to the Internal Revenue Service, Washington 25, D.C., Attention: T:S:EA:F, not later than June 30, 1957.

Cooperatives which have any special problems with respect to depreciation on their properties should take this opportunity to furnish the Service with a statement concerning their experiences and any suggestions they may have with respect to how the property with which they are concerned should be treated.

In an announcement in I.R.B. 57-13, the Service listed the following information "that would be welcomed by the advisory group":

> "(1) List of depreciable items not presently included in Bulletin "F".
>
> "(2) Estimated normal total useful lives by major items or classes of depreciable property. Where practicable, submit pertinent information as to factors affecting the normal useful lives recommended. (The normal total useful lives suggested should be for a normal operating schedule. Include a statement of the normal operating schedule used.) This relates to items presently included in Bulletin "F" as well as to new items.
>
> "(3) Where average or composite lives are suggested for an account or group, it is desirable to show how the life was computed."